Reducing the Deficit by Increasing Individual Income Tax Rates

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I. Introduction

Current federal budget policies are unsustainable. The long-run projections made by the Congressional Budget Office (CBO)[1] in June 2011 show the ratio of publicly-held debt-to-GDP, which was 40 percent at the end of 2008, rising from 69 percent in 2011 to 187 percent in 2035 under their Alternative Fiscal Scenario (AFS), which assumes that current federal spending and revenue policies will largely continue. Even under CBO's June 2011 Extended-Baseline Scenario, which assumes that all of the 2001-2003 tax cuts expire at the end of 2012, the Alternative Minimum Tax (AMT) will no longer be patched, and that Medicare and other health-related spending will be held to modest growth rates, debt held by the public is projected to rise to 84 percent of GDP by 2035. This paper examines whether increases in just the top two or three individual income tax rates alone could bring the national debt to a sustainable level. Other policies that could contribute to deficit reduction, such as adopting a value-added tax (VAT) or spending cuts, are not examined.

This paper focuses on three options that would increase individual income tax rates. All the options are assumed to be effective in 2015 and are analyzed against both a Current Law Baseline and a Current Policy Baseline. The Current Law Baseline assumes that provisions already in law to reduce future spending and increase revenues will remain unchanged. For example, the temporary tax cuts enacted in December 2010 are assumed to expire at the end of 2012 as scheduled, and the temporarily lower AMT exemptions for tax years 2010 and 2011 will expire. TPC's Current Policy Baseline assumes policies currently in effect, including the 2001-2010 tax cuts, other than temporary payroll tax relief, are permanently extended, and that the 2011 tax year AMT parameters are extended and indexed to inflation. TPC calculated the tax rates required under each option in order to meet a goal of reducing the publicly held debt-to-GDP ratio to 60 percent under each baseline in 2020, 2025, or 2035.

- Option 1 would increase all individual income tax rates, including the special rates that apply to capital gains and dividends. This option provides a basis for comparing the other two options.

- Option 2 would increase only the top three individual income tax rates, while leaving rates on capital gains and dividends unchanged.

- Option 3 would increase only the top two individual income tax rates, while leaving rates on capital gains and dividends unchanged.

The main finding is that increasing the top two or top three individual income tax rates alone cannot achieve the debt-to-GDP targets under some of the Current Policy Baseline scenarios. For example, under Option 3, even raising the top two individual income tax rates to nearly 100 percent[2], does not produce enough revenue to meet the debt-to-GDP targets in any goal year under the Current Policy Baseline. Similarly, Option 2, raising only the top three individual

[1] Congressional Budget Office (June 2011).
[2] The top rate was capped at 96.2 percent due to the 3.8 percent tax on "net investment income" passed as part of the Patient Protection and Affordable Care Act (PPACA) and scheduled to take effect in 2013.

income tax rates, does not meet the debt-reduction target for 2020 under a Current Policy Baseline. Therefore, to achieve the targets under these scenarios, an increase in the top income tax rates would need to be combined with spending reductions or other revenue measures. There are scenarios in which the debt-reduction targets could be achieved with the following rates:

- Under TPC's Current Policy Baseline, the top individual income tax rate under Option 1 would range from 43.6 percent to 45.4 percent, depending on the target year. The top rate under Option 2 would range from 89.3 percent (for target year 2035) and 91.8 percent (for target year 2025).

- Under the Current Law Baseline, the top individual income tax rate under Option 1 would range from 43.6 percent to 45.4 percent. The top rate under Option 2 would range from 49.4 to 54.1 percent. Under Option 3, the top rate would be 51.7 to 57.7 percent.

II. Baselines and Debt-Reduction Targets

Two baselines are used in this paper to determine the targets for debt reduction. The Current Law Baseline assumes provisions in current law that reduce future spending and increase revenues will remain unchanged in the future. The second baseline used in the paper, TPC's Current Policy Baseline assumes policies currently in effect continue.

Under both the Current Law and Current Policy Baselines, significant spending cuts, tax increases, or both will be required to avert the likelihood of a fiscal crisis at some time in the foreseeable future. Spending cuts or other tax changes in a broad debt-reduction plan would require smaller increases in the top individual income tax rates. This paper examines three options that rely solely on revenue changes to reduce the ratio of publicly held debt-to-GDP to 60 percent in 2020, 2025, or 2035, starting from either the Current Law Baseline or the Current Policy Baseline. The options all would be effective in 2015. Modeling of the options did not account for behavioral responses to the higher rates. If these behavioral responses were taken into account, the results would be even further from the debt-reduction goals.

III. Options: Income Tax Rate Increases to Meet Debt-Reduction Targets

Option 1 would increase all statutory individual income tax rates, including the special rates on capital gains (and qualified dividends under the Current Policy Baseline), but would not change the rates under the AMT or the 3.8 percent surcharge rate on investment income that will apply to high-income taxpayers after 2012. Option 2 would increase the top three statutory individual income tax rates on ordinary income, but leave unchanged the special rates on capital gains (and qualified dividends under the Current Policy Baseline), the rates under the AMT, and the 3.8 percent surcharge rate on investment income. Option 3 would increase only the top two statutory individual income tax rates on ordinary income and, like Option 2, would leave all other tax rates unchanged.

Statutory individual income tax rates differ between the two baselines. Under the Current Law Baseline, tax rates on ordinary income are 15, 28, 31, 36, and 39.6 percent, the maximum rates on capital gains are 20 percent (10 percent if the gain would otherwise be taxed at 15 percent) for property held between one and five years and 18 percent (8 percent if the gain would otherwise be taxed at 15 percent) for property held more than five years, and dividends are taxed at ordinary income rates.[3] Under the Current Policy Baseline, tax rates on ordinary income are 10, 15, 25, 28, 33, and 35 percent, and the maximum rates on capital gains held at least one year and qualified dividends are 15 percent (0 percent if the gain or dividend would otherwise be taxed at 10 percent or 15 percent). In addition to these differences in rates, there are differences in some corresponding taxable income bracket thresholds. Further, the exemption levels for the AMT are at pre-2001 law levels and not indexed for inflation in the Current Law Baseline, whereas they are at much higher levels and indexed in the Current Policy Baseline. These differences in the AMT exemption levels significantly affect both baseline revenues and the amount of revenue raised by any given change in regular tax rates.[4]

The options to increase only the top three[5] and top two tax rates on ordinary income cannot achieve the debt-reduction targets in some or any of the target years, respectively, under the Current Policy Baseline. In the simulations that TPC reports, which assume no behavioral response, it capped ordinary income tax rates at 96.2 percent. This rate would make the combined statutory income and payroll tax rates on wages, self-employment income, and net investment income (except capital gains and dividends) for high-income earners 100 percent, taking into account the 2.9 percent Medicare tax and additional surtaxes of 0.9 percent on wages and 3.8 percent on “net investment income” of high-income taxpayers enacted in the Patient Protection and Affordable Care Act (PPACA). Effective marginal rates could still exceed 100 percent due to interactions with other provisions of the income tax. Statutory marginal tax rates even approaching 100 percent are completely unrealistic, but are reported here to indicate the infeasibility of achieving a high debt-reduction target simply by increasing top individual income tax rates.

The Urban-Brookings Tax Policy Center microsimulation model was used to estimate the tax rates on ordinary income in 2015 under each baseline required to meet the debt-reduction targets in 2020, 2025, and 2035. For the option to increase all tax rates, the rates on long-term capital gains and (under the Current Policy Baseline) qualified dividends were increased by the same percentages as the rates on ordinary income. The calculations of all the rates in Table 1 are static, meaning they include no behavioral responses to any changes.

Option 1, to increase all rates, would result in a top rate on ordinary income under the Current Law Baseline ranging from 43.6 percent to 45.4 percent, and a top rate on capital gains (for gains held less than five years by high-income taxpayers) ranging from 25.8 percent to 26.7 percent, depending on the target year. For Option 1 under the Current Policy Baseline, the required top

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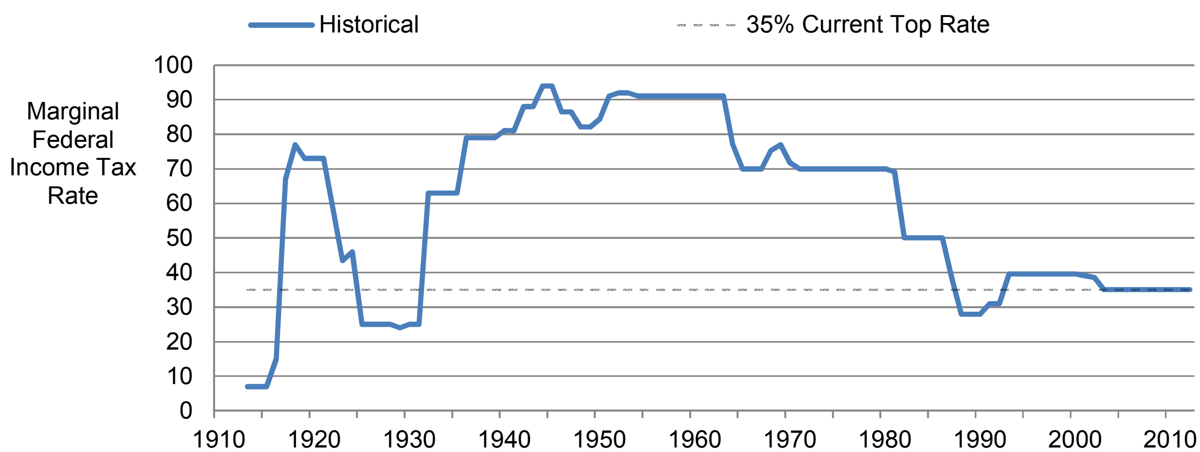
[3] The rates for capital gains (and qualified dividends under the Current Policy Baseline) cited here do not include the surcharge on capital gains, dividends, and other investment income of 3.8 percent that applies to high-income taxpayers. This surcharge is assumed not to be increased under any of the options.

[4] With a lower AMT exemption level, more taxpayers are subject to the AMT and would not be affected by higher regular income tax rates until the increase was sufficiently large to move these taxpayers off of the AMT.

[5] Increasing the top three rates under a Current Policy Baseline with a 2025 or 2035 goal did not cause these brackets to reach the 96.2 percent cap, but it still led to a top rate of 89.3 to 91.8 percent, extraordinarily high by American historical standards (although not unprecedented).

rate on ordinary income to reach the debt-reduction targets would range from 53.9 percent to 59.7 percent and the top rate on capital gains and qualified dividends from 26.9 percent to 29.4 percent, depending on the target year. Option 2, to increase only the top three tax rates on ordinary income, would result in a top rate ranging from 49.4 percent to 54.1 percent under the Current Law Baseline, and from 89.3 percent to the capped rate of 96.2 percent under the Current Policy Baseline. Option 3, to increase only the top two rates on ordinary income, would result in a top rate ranging from 51.7 percent to 57.5 percent under the Current Law Baseline, and would be capped at 96.2 percent for all three target years under the Current Policy Baseline. To put these rates in historical perspective, the top rate on ordinary income has not been above 40 percent since 1986, above 50 percent since 1981, or above 90 percent since 1963 (see chart).

Top Federal Individual Income Tax Rate On Ordinary Income, 1913 to 2012



Source: Internal Revenue Service.

Table 1
Individual Income Tax Rates for Joint Filers in 2015
Under the Current Law and Current Policy Baselines and
Tax Rate Options for 60% Debt-to-GDP Target Years 2020, 2025 and 2035

Taxable Income		Tax Rate (percent)			
			Option to Increase:		
Over	But Not Over	Under Baseline	All Rates	Top Three Rates	Top Two Rates
A1. Target Year 2020, Current Law Baseline (Target: 1.0% of GDP in 2015)					
$0	$60,600	15.0%	16.9%	15.0%	15.0%
$60,600	$146,450	28.0%	31.5%	28.0%	28.0%
$146,450	$223,200	31.0%	34.8%	40.5%	31.0%
$223,200	$398,600	36.0%	40.4%	47.1%	49.6%
$398,600	--	39.6%	44.5%	51.8%	54.6%
A2. Target Year 2020, Current Policy Baseline (Target: 5.4% of GDP in 2015)					
$0	$17,850	10.0%	17.1%	10.0%	10.0%
$17,850	$72,600	15.0%	25.6%	15.0%	15.0%
$72,600	$146,450	25.0%	42.6%	25.0%	25.0%
$146,450	$223,200	28.0%	47.7%	96.2% [1]	28.0%
$223,200	$398,600	33.0%	56.3%	96.2% [1]	96.2% [1]
$398,600	--	35.0%	59.7%	96.2% [1]	96.2% [1]
B1. Target Year 2025, Current Law Baseline (Target: 0.8% of GDP in 2015)					
$0	$60,600	15.0%	16.5%	15.0%	15.0%
$60,600	$146,450	28.0%	30.8%	28.0%	28.0%
$146,450	$223,200	31.0%	34.1%	38.7%	31.0%
$223,200	$398,600	36.0%	39.6%	44.9%	47.0%
$398,600	--	39.6%	43.6%	49.4%	51.7%
B2. Target Year 2025, Current Policy Baseline (Target: 4.3% of GDP in 2015)					
$0	$17,850	10.0%	15.7%	10.0%	10.0%
$17,850	$72,600	15.0%	23.5%	15.0%	15.0%
$72,600	$146,450	25.0%	39.2%	25.0%	25.0%
$146,450	$223,200	28.0%	43.9%	73.4%	28.0%
$223,200	$398,600	33.0%	51.7%	86.5%	96.2% [1]
$398,600	--	35.0%	54.8%	91.8%	96.2% [1]
C1. Target Year 2035, Current Law Baseline (Target: 1.2% of GDP in 2015)					
$0	$60,600	15.0%	17.2%	15.0%	15.0%
$60,600	$146,450	28.0%	32.1%	28.0%	28.0%
$146,450	$223,200	31.0%	35.5%	42.3%	31.0%
$223,200	$398,600	36.0%	41.3%	49.2%	52.3%
$398,600	--	39.6%	45.4%	54.1%	57.5%
C2. Target year 2035, Current Policy Baseline (Target: 4.1% of GDP in 2015)					
$0	$17,850	10.0%	15.4%	10.0%	10.0%
$17,850	$72,600	15.0%	23.1%	15.0%	15.0%
$72,600	$146,450	25.0%	38.5%	25.0%	25.0%
$146,450	$223,200	28.0%	43.2%	71.4%	28.0%
$223,200	$398,600	33.0%	50.9%	84.2%	96.2% [1]
$398,600	--	35.0%	53.9%	89.3%	96.2% [1]

Source: Urban-Brookings Tax Policy Center Microsimulation Model (versions 0509-6 and 0509-7).

[1] For these options and targets, the income tax rate was capped at 96.2% (see text)

Note that taxpayers are likely to adjust their behavior if income tax rates are increased. Even if work effort and saving were unaffected, taxpayers would find other ways to reduce reported taxable income. These behavioral responses include reduced reporting of taxable income (reflecting tax-avoidance responses, such as an increase in deductible forms of consumption and a substitution of tax-free fringe benefits for taxable wages), reduced realizations of capital gains, and reduced compliance. If such behavioral responses were taken into account, the tax rates required to meet the debt-reduction targets would be higher than the rates reported in Table 1, or for rates capped at 96.2 percent, far less revenue would be raised than indicated in Table 2 below.

IV. Effects of the Options

This section analyzes the effects of the options on government revenues, effective marginal tax rates, and the distribution of tax burdens.

Government Revenues

Tax rates for each option were set to achieve predetermined debt reduction targets in 2015. As discussed above, under the Current Policy Baseline the option to increase the top two income tax rates for all three target years and the option to increase the top three rates for target year 2020 fail to achieve the debt-reduction goals, even at the maximum possible rate of 96.2 percent and with no behavioral responses taken into account (see Table 2).

Table 2

Revenue Effects of Options in 2015 Under the Current Law and Current Policy Baselines for 60% Debt-to-GDP Target Years 2020, 2025 and 2035

($ billions)

Provision	Revenue in 2015 for 60% Debt-to-GDP Target Year: 2020	2025	2035
		Current Law Baseline	
Increase All Rates	**188.5**	**150.8**	**226.2**
Increase Top Three Rates	**188.5**	**150.8**	**226.2**
Increase Top Two Rates	**188.5**	**150.8**	**226.2**
		Current Policy Baseline	
Increase All Rates	**1,017.9**	**810.6**	**772.9**
Increase Top Three Rates	**979.0** [1]	**810.6**	**772.9**
Increase Top Two Rates	**689.6** [1]	**689.6** [1]	**689.6** [1]

Source: Urban-Brookings Tax Policy Center Microsimulation Model (versions 0509-6 and 0509-7).

[1] For these options and targets, the income tax rate was capped at 96.2% (see text)

Distribution of the Tax Burden

The distributional effects of the three options under both baselines and for each of the three target years were estimated using the Urban-Brookings Tax Policy Center microsimulation model. All distributional estimates are at 2015 levels of income. The incidence assumptions underlying the estimates are that individual income taxpayers bear the burden of their individual income tax liabilities, households bear the burden of the corporate income tax in proportion to their share of (positive) capital income, and workers bear the burden of both the employee and employer shares of the payroll tax in proportion to their earnings.

Estimates of the distributional effects in 2015 of the three options are shown by cash income percentile under each baseline for target years 2020 (Table 3A), 2025 (Table 3B), and 2035 (Table 3C). In all tables, distributional effects are expressed as the percentage change in a household's after-tax income. Note that under the Current Policy Baseline, Option 2 does not achieve the debt-reduction target for 2020 and Option 3 does not achieve the target for any year, so in these cases, the options raise less revenue (impose less total tax burden) than other income tax rate increase options. The estimates show that for all three target years and both baselines, all of the options are progressive across quintiles, with the options to increase the top three and top two income tax rates affecting only the top quintile.

Effects on Effective Marginal Tax Rates

The change in effective marginal tax rates (EMTRs) in 2015 on wages and capital gains due to the options were estimated using the Urban-Brookings Tax Policy Center microsimulation model. Estimates were made for each option under both baselines and for every target year, for wages (Tables 4A through 4C) and capital gains (Tables 5A through 5C). These estimates are expressed as percentage-point changes in EMTRs. As in the distributional tables, note that some options for increasing the income tax rate under the Current Policy Baseline do not achieve the debt-reduction targets because income tax rates were capped at 96.2 percent.

The estimates show that for all three target years and under both baselines, EMTRs on wages are increased in the bottom four quintiles by the option to increase all rates, but are essentially unaffected by the options to increase only top rates. Not surprisingly, EMTRs on wages in the top quintile, and particularly for the top 5 percent, are increased much more by the options to increase only the top rates (even when the rate increase is capped) than by the option to increase all rates. EMTRs on capital gains only are increased by the option to increase all rates because the other options are assumed to apply only to rates on ordinary income.

The options to raise only the top three or top two rates significantly increases EMTRs on wages while not achieving the debt-reduction targets. These results lead to the main finding of this paper: that increases in top rates alone cannot achieve significant debt reduction.

V. Conclusion

This paper examines whether increases in individual income tax rates, specifically the top rates, could reduce deficits enough to achieve future debt-to-GDP targets. TPC found that under Options 2 and 3, increasing the top three and two income tax rates, respectively, top rates approaching 100 percent would not raise enough revenue to meet the debt-to-GDP goal of 60 percent in some or all of the target years under the Current Policy Baseline. Given these findings, TPC determined that raising the top income tax rates would need to be combined with spending reductions or other revenue measures to meet debt-reduction goals in the specified target years.

Table 3A

Distributional Analysis of Options in 2015 Under the Current Law and Current Policy Baselines for 60% Debt-to-GDP Target Year 2020

(percentage change in after-tax income)

Cash Income Percentile	Options: Increase All Rates	Increase Top Three Rates[1]	Increase Top Two Rates[1]
	Current Law Baseline		
Lowest Quintile	-0.1	0.0	0.0
Second Quintile	-0.6	0.0	0.0
Middle Quintile	-1.1	0.0	0.0
Fourth Quintile	-1.3	0.0	0.0
Top Quintile	-2.5	-3.5	-3.5
All	-1.8	-1.8	-1.8
Addendum			
80-90	-1.7	-0.2	0.0
90-95	-1.7	-0.6	0.0
95-99	-2.2	-3.3	-2.3
Top 1 Percent	-4.0	-8.0	-9.3
Top 0.1 Percent	-4.4	-8.7	-10.6
Number on AMT (millions)[2]	12.3	22.5	24.5
	Current Policy Baseline		
Lowest Quintile	-0.5	0.0	0.0
Second Quintile	-2.7	0.0	0.0
Middle Quintile	-5.5	0.0	0.0
Fourth Quintile	-7.8	-0.1	0.0
Top Quintile	-12.9	-17.3	-12.2
All	-9.3	-9.0	-6.3
Addendum			
80-90	-9.8	-1.6	0.0
90-95	-11.1	-5.2	-0.2
95-99	-11.9	-19.9	-8.3
Top 1 Percent	-17.2	-34.7	-31.9
Top 0.1 Percent	-18.8	-36.0	-35.3
Number on AMT (millions)[3]	0.5	1.7	3.8

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-7).

[1] Note that under the Current Policy Baseline these options did not achieve the target because income tax rates were capped at 96.2%.

[2] The number of AMT taxpayers under the Current Law Baseline is 25.4 million.

[3] The number of AMT taxpayers under the Current Policy Baseline is 6.1 million.

Table 3B

Distributional Analysis of Options in 2015 Under the Current Law and Current Policy Baselines for 60% Debt-to-GDP Target Year 2025

(percentage change in after-tax income)

Cash Income Percentile	Income Tax Options: Increase All Rates	Income Tax Options: Increase Top Three Rates	Income Tax Options: Increase Top Two Rates[1]
	Current Law Baseline		
Lowest Quintile	-0.1	0.0	0.0
Second Quintile	-0.5	0.0	0.0
Middle Quintile	-0.9	0.0	0.0
Fourth Quintile	-1.1	0.0	0.0
Top Quintile	-2.0	-2.8	-2.8
All	-1.4	-1.4	-1.4
Addendum			
80-90	-1.4	-0.2	0.0
90-95	-1.3	-0.5	0.0
95-99	-1.7	-2.6	-1.9
Top 1 Percent	-3.3	-6.5	-7.5
Top 0.1 Percent	-3.6	-7.0	-8.5
Number on AMT (millions)[2]	14.0	22.8	24.6
	Current Policy Baseline		
Lowest Quintile	-0.4	0.0	0.0
Second Quintile	-2.1	0.0	0.0
Middle Quintile	-4.4	0.0	0.0
Fourth Quintile	-6.3	-0.1	0.0
Top Quintile	-10.2	-14.3	-12.2
All	-7.4	-7.5	-6.3
Addendum			
80-90	-7.9	-1.0	0.0
90-95	-8.8	-3.5	-0.2
95-99	-9.3	-14.5	-8.3
Top 1 Percent	-13.7	-31.0	-31.9
Top 0.1 Percent	-15.1	-33.1	-35.3
Number on AMT (millions)[3]	0.5	1.8	3.8

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-7).

[1] Note that under the Current Policy Baseline this option did not achieve the target because income tax rates were capped at 96.2%.

[2] The number of AMT taxpayers under the Current Law Baseline is 25.4 million.

[3] The number of AMT taxpayers under the Current Policy Baseline is 6.1 million.

Table 3C

Distributional Analysis of Options in 2015 Under the Current Law and Current Policy Baselines for 60% Debt-to-GDP Target Year 2035

(percentage change in after-tax income)

Cash Income Percentile	Income Tax Options: Increase All Rates	Increase Top Three Rates	Increase Top Two Rates[1]
	Current Law Baseline		
Lowest Quintile	-0.2	0.0	0.0
Second Quintile	-0.7	0.0	0.0
Middle Quintile	-1.3	0.0	0.0
Fourth Quintile	-1.6	0.0	0.0
Top Quintile	-3.1	-4.2	-4.2
All	-2.2	-2.2	-2.2
Addendum			
80-90	-2.1	-0.3	0.0
90-95	-2.1	-0.8	-0.1
95-99	-2.7	-4.0	-2.8
Top 1 Percent	-4.8	-9.5	-11.2
Top 0.1 Percent	-5.3	-10.4	-12.7
Number on AMT (millions)[2]	10.9	22.2	24.4
	Current Policy Baseline		
Lowest Quintile	-0.4	0.0	0.0
Second Quintile	-2.0	0.0	0.0
Middle Quintile	-4.2	0.0	0.0
Fourth Quintile	-6.0	-0.1	0.0
Top Quintile	-9.8	-13.6	-12.2
All	-7.1	-7.1	-6.3
Addendum			
80-90	-7.5	-1.0	0.0
90-95	-8.4	-3.3	-0.2
95-99	-8.8	-13.8	-8.3
Top 1 Percent	-13.1	-29.5	-31.9
Top 0.1 Percent	-14.4	-31.6	-35.3
Number on AMT (millions)[3]	0.6	1.8	3.8

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-7).

[1] Note that under the Current Policy Baseline this option did not achieve the target because income tax rates were capped at 96.2%.

[2] The number of AMT taxpayers under the Current Law Baseline is 25.4 million.

[3] The number of AMT taxpayers under the Current Policy Baseline is 6.1 million.

Table 4A

Effective Marginal Tax Rate (EMTR) and Changes in EMTR on Wages Due to Options in 2015
Under the Current Law and Current Policy Baselines for 60% Debt-to-GDP Target Year 2020
(EMTR as a percent or percentage point change in EMTR)

Cash Income Percentile	EMTR on Wages Under Baseline	Change in EMTR on Wages			EMTR on Wages		
		Increase All Rates	Increase Top Three Rates[1]	Increase Top Two Rates[1]	Increase All Rates	Increase Top Three Rates[1]	Increase Top Two Rates[1]
				Current Law Baseline			
Lowest Quintile	20.9	0.9	0.1	0.1	21.8	21.0	21.0
Second Quintile	33.2	1.8	0.0	0.0	35.0	33.2	33.2
Middle Quintile	36.2	1.8	0.0	0.0	38.0	36.2	36.2
Fourth Quintile	40.5	2.2	0.3	0.0	42.7	40.8	40.5
Top Quintile	41.2	4.1	6.2	5.3	45.3	47.4	46.5
All	38.8	3.0	3.1	2.6	41.8	41.9	41.4
Addendum							
80-90	39.6	3.6	1.1	0.1	43.2	40.7	39.7
90-95	40.6	2.3	3.1	0.2	42.9	43.7	40.8
95-99	41.7	5.7	11.3	9.7	47.4	53.0	51.4
Top 1 Percent	44.1	5.1	12.4	15.1	49.2	56.5	59.2
Top 0.1 Percent	44.1	5.0	12.4	15.3	49.1	56.5	59.4
				Current Policy Baseline			
Lowest Quintile	17.4	3.4	0.0	0.0	20.8	17.4	17.4
Second Quintile	32.3	8.8	0.0	0.0	41.0	32.3	32.3
Middle Quintile	33.9	12.3	0.0	0.0	46.2	33.9	33.9
Fourth Quintile	35.9	14.2	1.8	0.0	50.0	37.7	35.9
Top Quintile	38.1	19.7	36.2	20.9	57.8	74.3	58.9
All	35.7	15.7	17.7	10.0	51.4	53.4	45.6
Addendum							
80-90	38.3	17.4	7.6	0.1	55.6	45.8	38.4
90-95	37.3	17.4	33.7	1.0	54.6	71.0	38.2
95-99	39.2	20.5	58.3	36.8	59.7	97.5	76.1
Top 1 Percent	37.1	25.8	61.6	60.6	62.9	98.7	97.7
Top 0.1 Percent	38.0	24.7	60.6	60.4	62.7	98.6	98.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-7).

[1] Note that under the Current Policy Baseline these options did not achieve the target because income tax rates were capped at 96.2%.

Table 4B

Effective Marginal Tax Rate (EMTR) and Changes in EMTR on Wages Due to Options in 2015
Under the Current Law and Current Policy Baselines for 60% Debt-to-GDP Target Year 2025
(EMTR as a percent or percentage point change in EMTR)

Cash Income Percentile	EMTR on Wages Under Baseline	Change in EMTR on Wages: Increase All Rates	Change in EMTR on Wages: Increase Top Three Rates	Change in EMTR on Wages: Increase Top Two Rates[1]	EMTR on Wages: Increase All Rates	EMTR on Wages: Increase Top Three Rates	EMTR on Wages: Increase Top Two Rates[1]
				Current Law Baseline			
Lowest Quintile	20.9	0.7	0.1	0.1	21.6	21.0	21.0
Second Quintile	33.2	1.5	0.0	0.0	34.7	33.2	33.2
Middle Quintile	36.2	1.5	0.0	0.0	37.7	36.2	36.2
Fourth Quintile	40.5	1.8	0.2	0.0	42.3	40.7	40.5
Top Quintile	41.2	3.3	5.0	4.3	44.5	46.2	45.5
All	38.8	2.4	2.5	2.1	41.2	41.3	40.9
Addendum							
80-90	39.6	2.9	0.9	0.1	42.5	40.5	39.7
90-95	40.6	1.6	2.4	0.2	42.2	43.0	40.8
95-99	41.7	4.7	9.0	7.8	46.4	50.7	49.5
Top 1 Percent	44.1	4.2	10.1	12.2	48.3	54.2	56.3
Top 0.1 Percent	44.1	4.1	10.0	12.3	48.2	54.1	56.4
				Current Policy Baseline			
Lowest Quintile	17.4	2.7	0.0	0.0	20.1	17.4	17.4
Second Quintile	32.3	7.0	0.0	0.0	39.3	32.3	32.3
Middle Quintile	33.9	9.9	0.0	0.0	43.8	33.9	33.9
Fourth Quintile	35.9	11.4	1.2	0.0	47.2	37.1	35.9
Top Quintile	38.1	15.8	28.8	20.9	53.8	66.9	58.9
All	35.7	12.6	14.0	10.0	48.2	49.7	45.6
Addendum							
80-90	38.3	13.9	5.0	0.1	52.2	43.3	38.4
90-95	37.3	13.7	22.2	1.0	50.9	59.4	38.2
95-99	39.2	16.2	45.9	36.8	55.4	85.1	76.1
Top 1 Percent	37.1	21.0	56.8	60.6	58.1	93.9	97.7
Top 0.1 Percent	38.0	19.9	56.2	60.4	57.9	94.2	98.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-7).

[1] Note that under the Current Policy Baseline this option did not achieve the target because income tax rates were capped at 96.2%.

Table 4C

Effective Marginal Tax Rate (EMTR) and Changes in EMTR on Wages Due to Options in 2015 Under the Current Law and Current Policy Baselines for 60% Debt-to-GDP Target Year 2035

(EMTR as a percent or percentage point change in EMTR)

Cash Income Percentile	EMTR on Wages Under Baseline	Change in EMTR on Wages			EMTR on Wages		
		Increase All Rates	Increase Top Three Rates	Increase Top Two Rates[1]	Increase All Rates	Increase Top Three Rates	Increase Top Two Rates[1]
			Current Law Baseline				
Lowest Quintile	20.9	1.0	0.1	0.1	21.9	21.0	21.0
Second Quintile	33.2	2.1	0.0	0.0	35.3	33.2	33.2
Middle Quintile	36.2	2.2	0.0	0.0	38.4	36.2	36.2
Fourth Quintile	40.5	2.7	0.3	0.0	43.2	40.8	40.5
Top Quintile	41.2	5.0	7.5	6.4	46.2	48.7	47.6
All	38.8	3.6	3.7	3.1	42.4	42.5	41.9
Addendum							
80-90	39.6	4.4	1.3	0.1	44.0	40.9	39.7
90-95	40.6	3.0	3.9	0.3	43.6	44.5	40.9
95-99	41.7	6.7	13.5	11.7	48.4	55.2	53.4
Top 1 Percent	44.1	6.1	14.8	18.1	50.2	58.9	62.2
Top 0.1 Percent	44.1	5.9	14.8	18.2	50.0	58.9	62.3
			Current Policy Baseline				
Lowest Quintile	17.4	2.6	0.0	0.0	20.0	17.4	17.4
Second Quintile	32.3	6.7	0.0	0.0	39.0	32.3	32.3
Middle Quintile	33.9	9.5	0.0	0.0	43.4	33.9	33.9
Fourth Quintile	35.9	10.9	1.2	0.0	46.7	37.0	35.9
Top Quintile	38.1	15.0	27.5	20.9	53.1	65.5	58.9
All	35.7	12.0	13.4	10.0	47.6	49.1	45.6
Addendum							
80-90	38.3	13.3	4.8	0.1	51.5	43.1	38.4
90-95	37.3	13.0	21.1	1.0	50.3	58.4	38.2
95-99	39.2	15.4	43.7	36.8	54.6	83.0	76.1
Top 1 Percent	37.1	20.2	54.4	60.6	57.3	91.5	97.7
Top 0.1 Percent	38.0	19.0	53.7	60.4	57.1	91.7	98.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-7).

[1] Note that under the Current Policy Baseline this option did not achieve the target because income tax rates were capped at 96.2%.

Table 5A

Effective Marginal Tax Rate (EMTR) and Changes in EMTR on Capital Gains Due to Option in 2015 Under the Current Law and Current Policy Baselines for 60% Debt-to-GDP Target Year 2020

(EMTR as a percent or percentage point change in EMTR)

Cash Income Percentile	EMTR on Capital Gains Under Baseline	Change in EMTR on Capital Gains Under Option to Increase All Rates	EMTR on Capital Gains Under Option to Increase All Rates
		Current Law Baseline	
Lowest Quintile	4.9	0.3	5.2
Second Quintile	6.6	0.8	7.4
Middle Quintile	11.5	1.4	12.9
Fourth Quintile	16.0	1.9	17.9
Top Quintile	23.4	2.3	25.7
All	22.6	2.4	25.0
Addendum			
80-90	18.7	2.1	20.8
90-95	22.2	1.1	23.3
95-99	24.8	2.2	27.0
Top 1 Percent	23.4	2.5	25.9
Top 0.1 Percent	23.5	2.5	26.0
		Current Policy Baseline	
Lowest Quintile	1.4	0.1	1.5
Second Quintile	1.1	0.3	1.3
Middle Quintile	5.3	3.7	9.0
Fourth Quintile	9.1	6.3	15.4
Top Quintile	17.9	9.7	27.6
All	16.8	9.2	26.0
Addendum			
80-90	13.1	8.9	22.1
90-95	14.6	8.7	23.3
95-99	19.9	7.7	27.6
Top 1 Percent	18.1	10.3	28.4
Top 0.1 Percent	18.2	10.4	28.6

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-7).

Table 5B

Effective Marginal Tax Rate (EMTR) and Changes in EMTR on Capital Gains Due to Option in 2015 Under the Current Law and Current Policy Baselines for 60% Debt-to-GDP Target Year 2025

(EMTR as a percent or percentage point change in EMTR)

Cash Income Percentile	EMTR on Capital Gains Under Baseline	Change in EMTR on Capital Gains Under Option to Increase All Rates	EMTR on Capital Gains Under Option to Increase All Rates
		Current Law Baseline	
Lowest Quintile	4.9	0.3	5.2
Second Quintile	6.6	0.6	7.2
Middle Quintile	11.5	1.1	12.6
Fourth Quintile	16.0	1.6	17.6
Top Quintile	23.4	1.9	25.3
All	22.6	1.9	24.5
Addendum			
80-90	18.7	1.7	20.4
90-95	22.2	0.8	23.0
95-99	24.8	1.8	26.6
Top 1 Percent	23.4	2.0	25.4
Top 0.1 Percent	23.5	2.0	25.5
		Current Policy Baseline	
Lowest Quintile	1.4	0.1	1.5
Second Quintile	1.1	0.2	1.3
Middle Quintile	5.3	3.0	8.3
Fourth Quintile	9.1	5.1	14.2
Top Quintile	17.9	7.7	25.6
All	16.8	7.3	24.2
Addendum			
80-90	13.1	7.2	20.3
90-95	14.6	6.9	21.5
95-99	19.9	5.9	25.8
Top 1 Percent	18.1	8.3	26.3
Top 0.1 Percent	18.2	8.4	26.6

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-7).

Table 5C

Effective Marginal Tax Rate (EMTR) and Changes in EMTR on Capital Gains Due to Option in 2015 Under the Current Law and Current Policy Baselines for 60% Debt-to-GDP Target Year 2035

(EMTR as a percent or percentage point change in EMTR)

Cash Income Percentile	EMTR on Capital Gains Under Baseline	Change in EMTR on Capital Gains Under Option to Increase All Rates	EMTR on Capital Gains Under Option to Increase All Rates
		Current Law Baseline	
Lowest Quintile	4.9	0.4	5.3
Second Quintile	6.6	0.9	7.5
Middle Quintile	11.5	1.7	13.2
Fourth Quintile	16.0	2.3	18.3
Top Quintile	23.4	2.8	26.2
All	22.6	2.8	25.4
Addendum			
80-90	18.7	2.6	21.3
90-95	22.2	1.4	23.6
95-99	24.8	2.6	27.4
Top 1 Percent	23.4	3.0	26.4
Top 0.1 Percent	23.5	2.9	26.4
		Current Policy Baseline	
Lowest Quintile	1.4	0.1	1.5
Second Quintile	1.1	0.2	1.3
Middle Quintile	5.3	2.9	8.2
Fourth Quintile	9.1	4.9	13.9
Top Quintile	17.9	7.4	25.2
All	16.8	7.0	23.8
Addendum			
80-90	13.1	6.8	20.0
90-95	14.6	6.6	21.2
95-99	19.9	5.6	25.5
Top 1 Percent	18.1	7.9	26.0
Top 0.1 Percent	18.2	8.0	26.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-7).

Definitions of Tax Law and TPC Model Terms[6]

Alternative Minimum Tax (AMT). A supplemental income tax originally intended to ensure that high-income filers do not take undue advantage of tax preferences to reduce or eliminate their tax liability. The most common "preference" items, however, are for state and local tax deductions, personal exemptions, and miscellaneous itemized deductions-- not items normally thought of as preferences or shelters. Increasingly, this complicated tax applies to middle-income filers, in part because its exemption was not indexed for inflation and in part because Congress did not adjust the AMT to coordinate it with the 2001-2003 (EGTRRA and JGTRRA) tax cuts.

Capital Gains. The difference between the purchase and sale price of capital assets net of brokers' fees and other costs. Capital gains are generally taxable upon sale (or "realization"). Long-term gains, those realized after a year or longer, are taxed at lower rates than short-term gains, which are taxed at the same rates as other ("ordinary") income, such as wages and salaries. Taxpayers can deduct up to $3,000 of net losses (losses in excess of gains) each year against other income; taxpayers can carry over losses above that amount and deduct them from future gains.

Deduction. A reduction in taxable income for certain expenses. Some deductions, such as that for contributions to an Individual Retirement Account (IRA), are "above the line" meaning they are available to all taxpayers with the qualifying expense. Most deductions in the federal income tax, such as those for home mortgage interest and state and local taxes, are only available to those who itemize deductions. Most taxpayers choose not to itemize and instead claim the standard deduction because it provides a greater tax benefit. Because marginal tax rates increase with taxable income, deductions benefit high-income more than low-income taxpayers. Deductions cannot reduce taxable income below zero.

Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). A tax bill that reduced most tax rates, increased the child tax credit and made much more of it partially refundable, expanded tax-free retirement savings, reduced marriage penalties, increased the child and dependent care tax credit, and phased out the estate tax. Most provisions were scheduled to phase in slowly between 2001 and 2010 and then to expire at the end of 2010, but the expiration date has now been extended to the end of 2012. JGTRRA (see below) accelerated some of the EGTRRA tax cuts and added others.

Indexation. Annual adjustments to various parameters in the tax code to account for inflation and prevent bracket creep. Since 1981, many features of the federal individual income tax, including personal exemptions and tax brackets, have been indexed for inflation based on changes in the Consumer Price Index. For instance, with 5 percent inflation, a personal exemption of $1,000 would be raised to $1,050. More broadly, the term applies to all efforts to adjust measures of income to account for the effects of price inflation.

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[6] The entries, with some updates, are from the TPC Glossary at http://www.taxpolicycenter.org/briefing-book/glossary/definitions.cfm.

Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). The 2003 tax act that accelerated the phase-in of tax rate reductions scheduled under EGTRRA, reduced the tax rates applicable to capital gains and dividends, accelerated increases in the child credit amount, and temporarily raised the exemption amounts for the alternative minimum tax (AMT). Most provisions were scheduled to expire at the end of 2010, but the expiration date has now been extended to the end of 2012. The temporary increase in the exemption amounts for the AMT under JGTRRA have been extended several times and are now scheduled to expire at the end of 2011.

Marginal Tax Rate. The additional tax that would be paid on an additional dollar of income. It is a measure of the effect of the tax system on incentives to work more, save more, and shelter more income from tax. Provisions such as the phase out of tax credits can cause marginal tax rates to differ from statutory tax rates.

Payroll Taxes. Taxes imposed on employers, employees, or both that are levied on some or all of workers' earnings. Employers and employees each pay Social Security (OASDI) taxes equal to 6.2 percent of all employee earnings up to a cap ($106,800 in 2010) and Medicare (HI) taxes of 1.45 percent on all earnings with no cap. Those taxes are referred to by the names of their authorizing acts: FICA (Federal Insurance Contributions Act) or SECA (Self-Employment Contributions Act), depending on the worker's employment status. Employers also pay State and Federal Unemployment Taxes (SUTA and FUTA) that cover the costs of unemployment insurance.

Progressivity. A measure of how tax burdens increase with income. A progressive tax claims a proportionately larger share of income from higher-income than from lower-income taxpayers. Conversely, a regressive tax takes a larger share of income from lower-income households than from higher-income ones. Taxes that claim the same percentage of income from all taxpayers are termed "proportional."

Tax Burden. The total cost of taxation borne by a household or individual. The burden includes not only the costs of taxes paid directly but also those taxes paid indirectly through lower wages or a reduced return on an investment. For example, in addition to the employee portion of payroll taxes, a worker may also bear the employer's share in the form of lower wages or fringe benefits.

Tax Policy Center Microsimulation Model. A microsimulation model developed by the Tax Policy Center and based on data from the IRS Statistics of Income (SOI) public use files. TPC uses the model to estimate how proposals would affect revenue, the distribution of tax burdens, and incentives to work and save. It is very similar to the models used by the Treasury Department, the Joint Committee on Taxation, and the Congressional Budget Office.

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